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ABSTRACT

This guide introduces and updates information on the Arizona public school finance system. It is intended to promulgate a wider understanding of public school finance. It includes tables and figures listing revenue support trends and regulations. Topics cover school district financing prior to 1980, the "bucket-of-need" analysis of Arizona's equalized system for facility maintenance and operation, state aid, K-12 finance reform and Arizona's "equalized" system, and expenditures outside the budget limits. The guide also addresses the truth about taxation, offers recommendations on expenditures outside the school district budget limits, discusses funding issues for school construction and renovation, and explains charter school financing and revenue generation. The guide includes a glossary of terms and acronyms. Appendices contain a taxpayer commitment table and a description of the Arizona Tax Research Association. (GR)

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ARIZONA EDUCATION ANALYSIS

ED 457 668

# School Finance Primer

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## A Taxpayer's Guide to Public School Finance

by
**Michael Hunter**
**Mary Gifford**

February 2000

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A Project of the Goldwater Institute's

CENTER FOR MARKET-BASED EDUCATION

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# A Taxpayer's Guide to Public School Finance

## Introduction

Arizona's school finance system is arguably one of the most complex in the United States. Over the years, both the Arizona Tax Research Association (ATRA) and the Goldwater Institute have made efforts to keep taxpayers and policy makers up to date or to introduce them to the major moving parts of this rather involved topic.

This guide is merely the latest effort to bring about a wider understanding of public school finance. It is not intended to be either comprehensive or exhaustive. Instead, our objective was to make school district finance as accessible as possible to a wide audience of people who have no intention of becoming school finance experts. As taxpayers, however, we all have an interest in those components of school finance, especially areas of taxation and spending, that affect us most.

Because school finance has evolved and continues to evolve so rapidly, explanations of the subject tend to have relatively short shelf lives. It is our hope that this book will remain useful and meaningful as long as necessary. However, throughout you will find our recommendations for change to the current system. Obviously, we hope the problems to which we draw attention here will be resolved soon, making this publication obsolete.

Despite our efforts to simplify this subject, some of what you are about to read may still seem difficult to comprehend. Do not be alarmed. It is not your fault. Public school finance is extremely complicated — especially for school districts — with so many rules and exceptions and twists and turns it can be frightfully daunting even for those of us who make it our business to understand it.

You will read a number of terms in this document that will likely be unfamiliar to you. We have tried to include brief definitions within the discussion where appropriate, but we have also tried not to make the text more complicated by doing so. Hopefully, we have chosen the right balance. We have also included a glossary at the end of this guide with many terms commonly used in school finance circles.

In putting this guide together, the authors took advantage of a natural division of labor between them. Because school districts can levy property taxes and are the recipient of the lion's share of taxes through the state general fund, Michael Hunter's position as a senior research analyst for Arizona's only statewide taxpayer organization has resulted in countless hours of analysis on school district finances. He is frequently invited to speak to policy makers and citizens on public finance issues. Michael authored the sections of this guide relating to school districts.

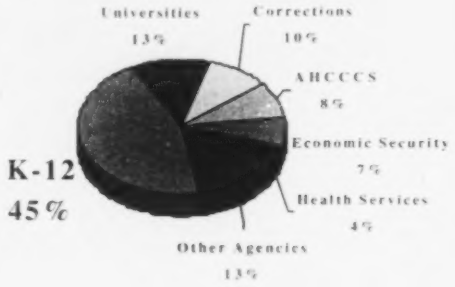
Mary Gifford has been a witness to Arizona's unprecedented charter school movement from the beginning and is widely regarded as an expert in charter school finance. Having served as executive director for the State Board for Charter Schools, she is now director of the Center for Market-Based Education at the Goldwater Institute. After moving to the Goldwater Institute, Mary was appointed by the Governor to serve as a member of the State Board for Charter Schools. Mary authored the portions of the guide relating to charter schools.

**Why should we care about public school finance?**

There are many ways to assess the level of importance a society places on a government program. Clearly, one way is to look at how much money citizens invest in that area compared to all the other areas to which it could dedicate funds. Last year (1999), public school finance (not including community colleges and universities) accounted for 46 percent of the $5.9 billion appropriated by the state. In addition, of the nearly $3.6 billion levied in local property taxes across the state, 58 percent was levied by school districts.

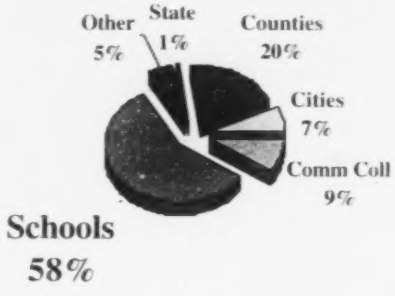
**Figure 1 – General Fund Appropriations and Statewide Property Tax Levies**

**FY 2000 State General Fund Appropriations**




Note: K-12 includes monies appropriated to the School Facilities Board
Source: State of Arizona Appropriations Report, Fiscal Years Ending June 30, 2000 and June 30, 2001, Joint Legislative Budget Committee.

**Statewide (total of local) Property Tax Levies, Primary and Secondary, 1999**

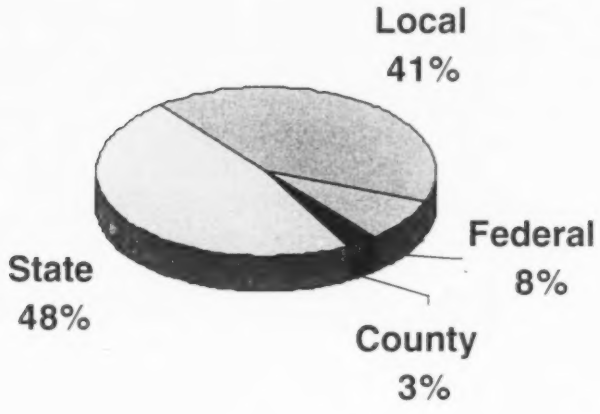



Source: Average Statewide Property Tax Rates: 1999 Tax Year, Arizona Department of Revenue.

The state's laws relating to education — preschool through university — are found in Title 15 of the Arizona Revised Statutes (A.R.S.). Of the approximately 800 pages of Title 15, over 600 pages are dedicated to K-12.

Most of our state and local taxes go to pay for public K-12 education. In fiscal year (FY) 1997-98, of the $4.4 billion spent on K-12, 48 percent came from state appropriations, with another 3 percent levied by the state through each of the fifteen counties. Forty-one percent was levied through local property taxes. The remaining 8 percent came from the federal government.

**Figure 2 – K-12 Education Revenue Sources**




Source: *Annual Report of the Arizona Superintendent of Public Instruction*, January 1999.

In the past 10 years, public school enrollments have increased nearly 44 percent. Meanwhile, taxpayer support, in the form of state appropriations and local property taxes for public schools, adjusted for inflation, has grown 59 percent. The increase in taxpayer support in the last decade is 110 percent without taking inflation into account. (See the table in appendix A for more information and our perspective on the value of inflation adjustments).

This guide should help you understand what underlies these numbers, as well as some of the issues that should be of most concern to taxpayers.

**School district finance prior to 1980**

School finance in Arizona (and many other states for that matter) was greatly influenced by events in California during the 1970s. Prior to that time, Arizona's system was like most others: heavy reliance on local property taxes and little influence or support from the state. Districts with a lot of property wealth could, with relatively low tax rates, raise a lot of revenue. On the other hand, taxpayers in districts with low property wealth could be faced with highly burdensome tax rates that would yield comparatively less revenue for the schools.

In 1971, the California Supreme Court ruled in *Serrano v. Priest* that our westward neighbor's method for funding school operations, with a heavy reliance on inherently unequal property taxes, was unconstitutional. In the years that followed, courts in many other states made similar rulings — the public financing of a student's education could not be dependent upon the property wealth of the school district in which the student resides.

For this state the fundamental guide for public schools is Article XI, Section 1, in the Arizona Constitution, which provides that "[t]he legislature shall enact such laws as shall provide for the

establishment and maintenance of a general and uniform public school system." When you hear that the courts are involved in a school finance dispute, you can pretty much count on the terms "general and uniform" coming up.

**K-12 Finance Reforms and Arizona's "equalized" System**

It wasn't until 1980 that inequities in taxation and spending among school districts were targeted in earnest. That same year, property tax reforms took place in Arizona, placing limits on government's ability to levy property taxes. Similar limits were not placed on school district levies however. Instead, the legislature passed laws intended to reduce disparities in tax rates, equalize per-pupil spending for maintenance and operations (M&O), and decrease reliance on local property taxes for schools. Although school districts were allowed the local prerogative of voter-approved budget overrides paid for out of secondary taxes, primary taxes would be levied through an equalized, "qualifying tax rate" (QTR), regardless of property values.

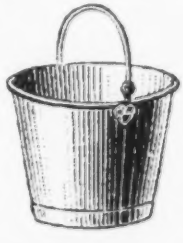
The state adopted a "foundation" system where spending needs are determined by a weighted student count (which we will explain shortly) and other variables to account for differing student needs. The result of these calculations is an "equalization base" of guaranteed funding. That base serves as an equalizing spending limit, of sorts, funded by local property tax levies and state appropriations.

The legislature expressed their intent in law with the following words:

> *The legislature intends by this act to increase the authority and responsibility of local school boards in determining how revenues will be utilized. Beginning in the 1980-81 fiscal year disparities in operational revenues among districts will be reduced on an annual basis until complete equalization is reached in the 1985-86 fiscal year.*

**The Bucket of Need**

So, let's see if we can conceptualize this so far. One way to think about Arizona's equalized system for M&O is to use a "bucket of need" metaphor. Bear with us here. Imagine that in June of every year administrators from each of Arizona's 226 school districts have the job of obtaining their school district's operating money for the district's fiscal year that starts July 1 and ends June 30. To do this, each person will get a bucket. Then, each administrator will have to fill the bucket with money.



However, because the size of each school district can vary considerably from other districts, the buckets are not all the same size. Some buckets are large, others small. So, the first step for each administrator is to determine the appropriate bucket size. To do this, they each have to count how many students they had on average in the district at the prior year's 100$^{th}$ day of school. This student count figure is called average daily membership, or ADM.

OK. So now we've counted heads, that is, ADM. The district administrators are starting to get an idea of the size of their bucket. But, of course, not all students cost the same to educate. Some students require a little extra help, and therefore a little extra money, compared to most other students. For example, high school students cost more to educate than elementary school

students. To account for those students, the total student count is multiplied by what are called "Group A weights." Interestingly, each elementary school student does not start at a baseline "weight" of 1.000. Rather, the baseline weight is 1.158. By comparison, high school students are each accounted for using a weight of 1.268. There are also weights that correspond to the size of the overall district enrollment — the smaller the school population, the higher the weight. But beyond these simple distinctions there is also the need to recognize that some students may have learning or emotional disabilities, mild mental retardation, speech or language impairments or other conditions that require extra help. The idea is that, for purposes of determining a district's bucket of need, all students get to count for a little more than 1.0 student to reflect the fact that some will cost more than others.

In the case of other students, however, specific disabling conditions have been given additional weights. These are called "Group B weights." These include severe mental retardation, autism, visual or hearing impairment, etc. The weights can go as high as 6.025 (for multiple disabilities or severe sensory impairment.) Unlike the Group A weights which are added to each and every student's count, Group B weights are added to only those students who have been identified with a specified condition. So, for purposes of determining a school district's student count, in some instances one student may count for six. The result, after applying the appropriate weights, is the determination of what is known as the weighted student count.

Now that the school district knows its weighted student count, the final step in determining the size of the bucket is to multiply that number by an amount set by the legislature called the base support level. For FY 1999-2000, the base support level was set at $2,578.41 per student. When you hear people say that the legislature increased — or did not increase — money for schools, the base support level is usually what they are talking about. The table below shows the increases in the base support level since FY 1988-89.

**Table 1 – Base Support Level, FY 1988-89**

| FY | Base Support | Increase | Percent Change |
|---|---|---|---|
| 1988-89 | $2,206.00 | $64.75 | 3.0% |
| 1989-90 | $2,281.00 | $75.00 | 3.4% |
| 1990-91 | $2,374.52 | $93.52 | 4.1% |
| 1991-92 | $2,398.27 | $23.75 | 1.0% |
| 1992-93 | $2,410.26 | $11.99 | 0.5% |
| 1993-94 | $2,410.26 | $0.00 | 0.0% |
| 1994-95 | $2,458.47 | $48.21 | 2.0% |
| 1995-96 | $2,462.94 | $4.47 | 0.2% |
| 1996-97* | $2,459.64 | -$3.30 | -0.1% |
| 1997-98 | $2,499.53 | $39.89 | 1.6% |
| 1998-99 | $2,532.60 | $33.07 | 1.3% |
| 1999-00 | $2,578.41 | $45.81 | 1.8% |

*The decrease for FY 1996-97 was due to the recalculation of the employee retirement recapture contribution.

Remember this is NOT the per-pupil distribution. It is the base by which the total weighted student count gets multiplied. As an illustration, let's say an elementary student's weighted

count is 1.158 (the group A weight). Multiplying that by $2,578.41 (the base support level) you get $2,985.80. But if that student also happens to be severely disabled, a group B weight (6.025) would apply. Multiplying 6.025 by $2,578.41 you get $15,534.92. The funding for that student would be the total of A and B, or $18,520.72 (plus applicable state and federal grants).

OK. We're getting there. We've got the biggest components of the bucket of need almost figured out. By multiplying $2,578.41 by the weighted student count, we are trying to determine what is called the revenue control limit, or RCL. Remember, this is primarily for M&O expenditures. Most of M&O is for salaries and benefits of administrators, teachers, and other district employees. There are actually a few more steps, as in the RCL formula shown here, that we won't go into. Suffice it to say that the largest component of the equalization base, that is the bucket of need, is the RCL, which is determined by applying the following math:

**Weighted Student Count**
***times***
**Base Support Level**
***times***
**Teacher Experience Index**
***times***
**Career Ladder Program or Performance Incentive Program (both optional)**
***plus***
**Transportation Revenue Control Limit (TRCL)**

There are just two more calculations, similar to the RCL steps above, that go toward finalizing the size of the bucket. One is to figure out the capital outlay revenue limit, or CORL. This is money that was originally intended to be spent on renovations or building maintenance, etc., but, which now can be transferred over to M&O subject to certain historically-based limitations. CORL is determined by multiplying the weighted student count by an per pupil amount set by the legislature. Then a per-pupil allowance is added to this figure for high school students for text books.

The third and last part of the equalization base, which we are still thinking of as a bucket for now, is called the soft capital allocation. The soft capital allocation has only been in existence since 1998 when it was adopted with the capital finance reforms called Students FIRST. (We will get into Students FIRST shortly.) Prior to Students FIRST, the soft capital allocation was called the capital levy revenue limit (CLRL). But let's not dwell on the past. What you need to know for now is that the soft capital allocation is calculated by multiplying the un-weighted student count by another per pupil amount set by the legislature, and is intended to provide resources for such so-called soft capital items as computers and lab equipment, capital equipment with relatively short useful lives.

And there we have it. The three parts of the bucket of need, i.e. the equalization base:

**Revenue Control Limit**
**(RCL)**
*plus*
**Capital Outlay Revenue Limit**
**(CORL)**
*plus*
**Soft Capital Allocation**

Now the district administrator knows the size of the district bucket of need. The next step is, of course, to fill the bucket. He will go to three places, the local district property taxpayers, the county property taxpayers, and the state treasury.

First districts go to their local property taxpayers. Using an equal tax rate called the qualifying tax rate, or QTR, the district determines how much money can be levied to fill in the bucket. The QTR is currently $4.33 for unified districts and $2.17 for high school or elementary districts. This rate is theoretically applied to every $100 of the district's net assessed value (NAV). NAV is the total taxable value of a taxing jurisdiction.

Because their NAV is relatively high, a handful of districts will completely fill their buckets with just local property taxes at rates equal to or less than the QTR. For several others, the local property tax values will be so low that the amount yielded by the QTR will be very little, barely covering the bottom of the bucket, as it were. The remaining districts will fall somewhere in between. They will get varying amounts of money from the locals, but not enough to fill the bucket.

Then the county education levy is added to the bucket. Actually, it is not exactly right to call this a county levy. The state law requires it and the state legislature sets the rate, currently 52 cents per $100 of countywide NAV. You may have thought that Arizona hasn't had a property tax since 1995 when it was repealed, but this county education rate is actually a state rate, yielding over $24 million statewide in 1999. This is the first draw on state equalization.

The district then goes to the state treasury. Every year the state legislature appropriates money from the general fund (the main account) specifically for state assistance to schools, sometimes called equalization assistance. Whatever the size of the bucket, whatever the local contribution turns out to be, the state guarantees that every bucket will be full.

And there you have it. Notwithstanding a few complicating details, Arizona's approach to equalized K-12 funding looks something like this:

**School District Spending Limit**
**(Equalization Base)**
*minus*
**Local Contribution**
**(QTR)**
*equals*
**State Aid**
**(Equalization Assistance)**

Here is a simplified example (considering only the RCL) of how it would work for two hypothetical unified districts (i.e. elementary and high school), each with exactly the same weighted student count, but one with only half the property value (NAV) of the other:

| **"Property Rich"** | **"Property Poor"** |
|---|---|
| $2,578.41 x 1,000 students (weighted ADM)<br>**$2,578,410 guaranteed** | $2,578.41 x 1,000 students (weighted ADM)<br>**$2,578,410 guaranteed** |
| *How much will come from local property taxes?*<br>$50,000,000/$100<br>(district's taxable value)<br>x<br>$4.33 QTR<br>**= $2,165,000**<br>**(84% of guaranteed amount)** | *How much will come from local property taxes?*<br>$25,000,000/$100<br>(district's taxable value)<br>x<br>$4.33 QTR<br>**= $1,082,500**<br>**(42% of guaranteed amount)** |
| *How much will come from the state general fund and county property taxes?*<br>$2,578,410<br>minus<br>$2,165,000<br>**=$413,410**<br>**(16% of guaranteed amount)** | *How much will come from the state general fund and county property taxes?*<br>$2,578,410<br>minus<br>$1,082,000<br>**=$1,495,910**<br>**(58% of guaranteed amount)** |

The above comparison would also work for elementary or high school districts, but the QTR would be $2.17 instead of $4.33.

The calculations used to determine the equalization base are substantially the same for determining funding levels for Arizona's charter schools, which we will discuss shortly. However, charter schools do not have access to the property tax. All of their funding is distributed from the state.

Another striking contrast between district and charter schools has to do with budget adjustments for changes in the student count. As we pointed out earlier, school district budgets adopted in

June for the upcoming fiscal year are based on the 100th day weighted student count from the previous year. Disbursements (called apportionments) of state revenue to the school district are made throughout the school year. If, at some point after the school year starts, enrollments appear that they will come in higher at the next 100th day count than the previous 100th day count on which the budget was based, school districts can ask for an advance payment. This is usually done at the 40th day. When the 100th day comes around this adjustment for enrollment growth is made official and additional state aid is provided, if warranted, through subsequent apportionments. The amount is not adjusted downward, even if enrollments during the current school year fall short of the prior-year 100th day count.

The section on charter schools in this guide will demonstrate that the rules for charter schools are very different. Charter school apportionments can be adjusted, upwards or downwards, in accordance with changes in enrollments throughout the school year.

**Equalization Summary**

The equalization base serves as sort of a budget limit. Each of the components of the equalization base is the result of a calculation. For each calculation there are fundamentally two variables: 1) student count ; and 2) an amount of money specified by the legislature.

For district schools, the idea with all this equalization is that, regardless of the "natural" disparities between districts in property values, taxpayers would pay the same rate. Taxpayers could choose at the ballot box to tax themselves more for budget overrides or general obligation bonds, but the majority of school budgets would be fairly equal.

From 1980, to equalize spending, budget limits were put in place (in our metaphor, the bucket of need was established). With some exemptions for certain specified things (which we will get into shortly), districts cannot spend beyond these limits. To equalize the tax burdens, the QTR is generally used to determine the local contribution to the school district, with the state supplying any remainder. One year after adopting this new system in 1980, state aid appropriations increased 40 percent. Between 1979 and 1999, state appropriations for K-12 climbed 571 percent, going from $421.5 million just prior to reform to today's $2.8 billion.

Meanwhile, property tax levies have also grown over the 20-year period. Total combined property taxes levied by school districts have gone from $371.1 million in 1980 to $2.1 billion in 1999. This includes both primary taxes (which are constitutionally limited but not voter approved) and secondary taxes (which are unlimited but voter approved).

During the last two decades primary levies went from $295.7 million to $1.3 billion. This growth has mainly been the result of three factors: 1) adjustments (or lack thereof) to the QTR; 2) changes in primary assessed values; and 3) growth in expenditures outside the equalized spending limits.

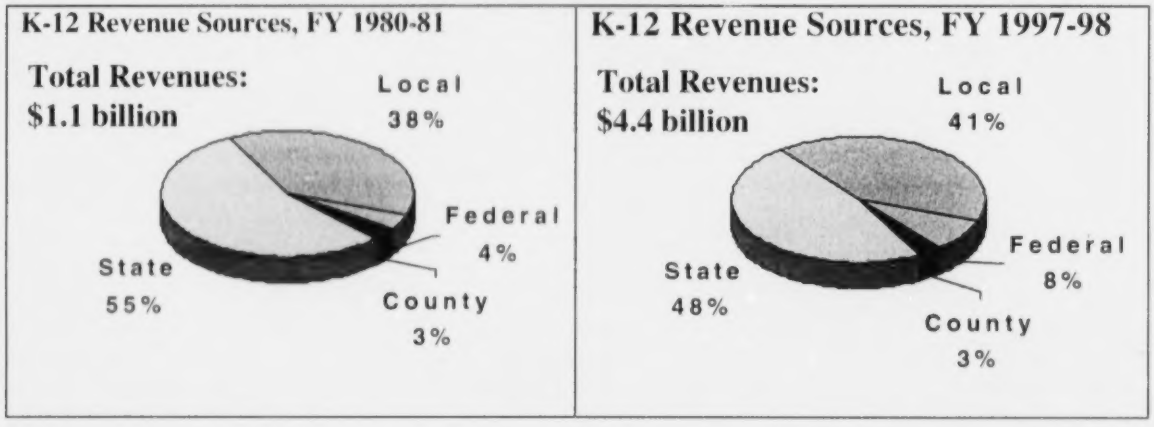
Part of the deal when the legislature adopted these reforms was that in order to help decrease reliance on local property taxes to fund schools, or at least keep it from increasing, the QTR, would be adjusted every year to reflect changes in property values. In 1980 the QTR was set at $5.40 for unified districts (half that for high school and elementary). The rate did drop in the three following years, to $5.20, $4.96, and $4.72 in 1983. However, it stayed at the $4.72 rate

for the next 13 years until 1996 when the legislature dropped the rate to $4.40. The QTR remained at that level until 1999 when, responding to the newest component of the "truth in taxation" laws, the state reduced the rate commensurate with increases in property values to its current level of $4.33.

If the system worked just as explained above, we would have equalized spending and taxes. However, per-pupil expenditures and primary tax rates across districts do not resemble what one might expect of an equalized system.

We said earlier that the legislature's goal in 1980 was to equalize per-pupil spending. To do this, they resolved to reduce school districts' reliance on the local property taxes. In the beginning of this discussion we included a pie chart on K-12 Revenue Sources showing that 41 percent came from local property taxes and 48 percent from the state. Now let's compare that chart for FY 1997-98 with one representing FY 1980-81. Total revenues have quadrupled. Have we reduced reliance on local property taxes?

**Figure 3 – K-12 Revenue Sources, FY 1980-81, FY 1997-98**




Clearly we have not. In fact, the slice of pie representing local property taxes has grown three percent. Why?

**Expenditures Outside the Budget Limits**

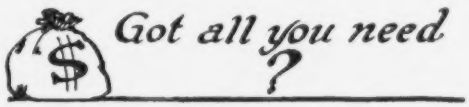
The most serious problems in K-12 finance from a taxpayer perspective are the expenditures identified in statute as exemptions from the school district budget limits. Increasing approximately 753 percent from the $34.7 million in fiscal year (FY) 1986-87, the second year the system was supposed to have been equalized, taxpayers statewide now pay $296 million in primary property taxes for unequalized expenditures.

What this means is that in many instances, and for substantial portions of their total expenditures, school districts have returned to the inequities in taxation and spending the 1980 reforms were intended to repair.

As we saw above in the discussion of the equalized system, much of a school district's spending level and taxation is not within the district's control. A district can't really control the number

or type of students. Nor can a district control the dollar amounts the legislature sets for the various parts of the equalization base.

Districts can ask their voters to approve M&O overrides for up to 10 percent of the RCL. Similarly, districts can request CORL overrides and general obligation bonds for capital projects. These overrides and bonds are paid for through local *secondary* property taxes, which are for voter-approved property taxes. But a district cannot require this extra tax of their taxpayers. They can only request it. Voters decide these issues, not districts.




But districts *can* control the expenditures, and the associated taxes, for certain items outside the budget limits. Let's talk about some of these.

***Desegregation***

The largest part of these expenditures (and associated levies) outside the limits is for desegregation. Starting with Tucson Unified in FY 1983-84, there are now 17 districts levying a total of $141 million annually for desegregation. In FY 1986-87, just over $9.2 million was levied statewide for desegregation. During FY 1998-99, just over half of the desegregation expenditures in Arizona were in two school districts: Tucson Unified and Phoenix Union High School District.

Current statute authorizes a school district to levy and spend revenue beyond their budget limits if that district has (or had) a court order of desegregation or an administrative agreement with the U.S. Department of Education Office of Civil Rights (OCR). Even if the desegregation order or OCR agreement ends, the district can continue to levy for desegregation expenditures.

While the courts are putting an end to desegregation orders in urban school districts across the country, Arizona seems to be going backward. School districts are moving more and more expenditures from within the equalized, limited, funds to projects funded outside the equalized system. In many districts, new spending initiatives are being dubiously financed under the banner of desegregation.

**Table 2 - FY 1998-99 Budgeted Expenditures for Desegregation**

| District | Deseg Expenditures | Deseg Rate* |
|---|---|---|
| Tucson Unified District | $42,159,848 | 2.3983 |
| Phoenix Union High Sch Dist | $37,401,852 | 1.3018 |
| Tempe Elementary District | $10,413,878 | 1.2023 |
| Phoenix Elementary District | $8,236,206 | 1.7714 |
| Roosevelt Elementary District | $6,732,534 | 2.9463 |
| Mesa Unified School District | $6,372,200 | 0.3938 |
| Cartwright Elementary District | $5,808,000 | 2.9467 |
| Isaac Elementary District | $5,510,229 | 5.6515 |
| Glendale Union High Sch Dist | $4,403,247 | 0.4055 |
| Scottsdale Unified District | $3,690,786 | 0.1891 |
| Amphitheater Unified District | $3,121,500 | 0.5031 |
| Holbrook Unified District | $2,240,000 | 5.8720 |
| Washington Elementary District | $1,785,000 | 0.2004 |
| Wilson Elementary District | $1,645,670 | 1.5164 |
| Flagstaff Unified District | $1,028,373 | 0.1942 |
| Agua Fria Union High Sch Dist | $624,275 | 0.3685 |
| Maricopa Unified School Dist | $162,035 | 1.1024 |
| **State Total** | **$141,335,633** | |

Source: Arizona Department of Education, * per $100 NAV

Note that each district listed above levies a different amount for desegregation. Tucson Unified spends the most, over $42 million, which adds about $2.40 to their tax rate. Isaac Elementary, at $5.5 million, levies considerably less. But the cost to Isaac's taxpayers for that levy, as measured by the tax rate, is about $5.65 per $100 of assessed value.

A special study by the Auditor General in 1990 reported to the legislature that, "Ten districts used this provision to budget $47.3 million for desegregation in fiscal year 1990-91." The report further documented that, "Expenditures more than doubled between fiscal years 1987-88 and 1989-90, increasing from $15.9 million to $33.8 million." The study, which was limited to only five of the 10 districts then levying for desegregation, also revealed that "some costs charged as desegregation were not related to their orders and agreements" and that all districts appeared to have expended funds under the desegregation law that had previously been funded from state or other local funds.

The Auditor General's report concluded: "some commonly accepted aspects of accountability appear to be lacking in Arizona's desegregation finance process." The report recommended that the Legislature take steps toward strengthening accountability and increasing the State's role in formulating desegregation plans."

In an era when courts are lifting desegregation orders for many urban school districts across the country, taxpayers in Arizona should bring into question what districts like TUSD and PUHSD have been doing in the name of desegregation.

***Other expenditures outside the limits***

Desegregation is only the largest of several other expenditure categories that are unequalized. The table below shows most of the expenditures outside the budget limits.

**Table 3 – School District Expenditures Outside the Budget Limits**

| Expenditure | FY 1986-87 | FY 1998-99 | Difference from FY87 to FY99 | Percent Change |
|---|---|---|---|---|
| Desegregation | $9,225,000 | $141,335,633 | $132,110,633 | 1432.1 |
| Excess Utilities | $10,106,543 | $55,924,815 | $45,818,269 | 453.4 |
| BBCF | $0 | $39,265,634 | $39,265,634 | 100 |
| Adjacent Ways | $3,116,417 | $29,542,497 | $26,426,080 | 100 |
| Small School Adj. | $0 | $9,644,661 | $9,644,661 | 100 |
| Liabilities in Excess | $0 | $8,503,226 | $8,503,226 | 100 |
| Dropout Prev | $0 | $5,279,631 | $5,279,631 | 100 |
| Energy Saving Devices | $0 | $4,419,868 | $4,419,868 | 100 |
| Excess Insurance | $12,268,577 | $2,011,497 | -$10,257,080 | -83.6 |
| Registered Warrants | $0 | $80,412 | $80,412 | 100 |
| **Total** | **$34,716,540** | **$296,007,874** | **$261,291,334** | **752.6** |

The legislature has eliminated two of these, phasing out energy saving devices, and excess insurance. The remaining categories require some brief explanation.

***Excess Utilities.*** Funded by unequalized property tax levies, excess utilities represent any increase over actual utility costs for FY 1984-85 (with some exceptions relating to costs associated with career ladder or teacher compensations programs).

***Budget Balance Carry Forward (BBCF).*** District can carry forward as much as four percent unspent budget capacity from its RCL in one year to build extra spending capacity in the next. It does not cause a direct increase in property taxes but could negate a tax decrease.

***Adjacent Ways.*** School districts can levy primary property taxes outside the budget limits for capital projects adjacent to school property. Common examples are sidewalks, sewers, utility lines, roadways, etc. Unlike other capital improvements paid for through capital overrides or general obligation bonds, no public discussion is required for adjacent ways projects. Although these are often basic capital needs, the current policy of the School Facilities Board (defined later) is not to pay for projects off school property.

***Small School Adjustment.*** Schools with less than 125 elementary students or 100 high school students have statutory authority to levy primary property taxes above and beyond the equalized system. There is no limit. The highest primary tax rates in the state for school districts tend to be for these statutorily-defined small school districts.

***Liabilities in Excess.*** Under the legal designation "liabilities in excess of the budget" school districts can levy for capital needs that result from unplanned damage to facilities for health and safety needs. This statute can also be used for excessive and unexpected legal expenses,

although it is usually invoked for capital projects. The law requires the district to seek approval from their county's board of supervisors. Except in rare instances, approval is routinely given. Many districts, especially the Phoenix Union High School District have been using this for planned capital projects to extend the life of their voter-approved bonds.

***Dropout Prevention Programs***. All expenditures to fund dropout prevention programs, which are limited by formula, are not subject to the RCL.

***Registered Warrants***. Eligible districts may budget outside the RCL an amount less than or equal to interest expenses for registering warrants or tax anticipation notes, both of which are basically short-term loans.

**Truth in Taxation**

Since 1997, school districts have been required by statute to disclose to their taxpayers their intention to raise taxes for expenditures outside the limits, as we said above, for those items they directly control. The law was called Truth in Taxation (TNT). If a school district proposes a budget with increased aggregate expenditures for these categories, the district must publish an announcement to that effect in a paper of general circulation within the district. The announcement must also contain the time and location for a public hearing on the tax increase that must take place prior to the budget adoption. Additionally, each board member's vote must be recorded in a public meeting.

Last summer, according to the Property Tax Oversight Commission, 116 districts did not raise taxes for these expenditures outside the limits. The other 110 districts did. But of those only 58 districts published an announcement and held a hearing. This means that 53 percent of the districts subject to the provisions of the TNT law did not comply.

**Recommendations on Expenditures Outside the School District Budget Limits**

Both the Goldwater Institute and ATRA have long advocated a market-based, child-centered, per-pupil funding reform. We believe that a system in which a specific amount of money follows each child to the school of his or her parent's choice will be the most fair, equitable, and "general and uniform." We also believe there are indications that the long-entrenched opposition to market-based reforms is beginning to come around. Time will tell, and we make no predictions on how long it will take for Arizona ultimately to do the right thing and fully embrace market-based reforms.

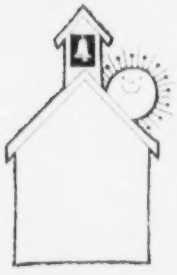
In the meantime, there are specific things the legislature can do to improve school district school finance. First, the legislature should revisit each of the areas where expenditures are allowed outside the budget limits for K-12 districts. If expenditure outside the limits is not merited, eliminate it. If the expenditure is a legitimate exception to equity, it should be brought within the budget limits, thus equalizing it.

If the legislature is not yet ready to do that, they need to consider reinforcing the TNT laws for schools. If school districts continue to ignore or circumvent their legal obligation to disclose their intention to raise taxes, the legislature should consider replacing TNT's notification

requirements, as other states have done, with a condition that every property tax hike receive voter approval.

**School construction and renovation**

Prior to 1998, schools were built primarily through bonded indebtedness. Payments on that debt were generated from secondary property taxes. In 1994 the Supreme Court ruled *in Roosevelt v. Bishop* that this reliance on inherently unequal property taxes to fund school construction and renovations was unconstitutional. The legislature's ultimate response, called Students FIRST, went into effect in 1998 and represents a fundamental change to school capital finance.



**What the law does**

The new law replaces voter-approved general obligation bonding as the first source for school construction with a centralized state funding system and establishes building adequacy requirements. The new system contains three major funding components: new school facilities, building renewal, and deficiency correction. Thus it contains measures for curing existing deficiencies in order to bring all school districts up to new state standards and it uses formulaic mechanisms to fund school building renewal and new construction to ensure schools continue to meet the standards over time. These funds are distributed and overseen by a nine-member panel called the School Facilities Board (SFB).

**Bonds and Capital Overrides**

The vast majority of future school capital funding will come from the state system. However, the law does provide for limited bonding, called Class B bonds to distinguish from the old (now called Class A) bonds. The Arizona Constitution limits the amount of debt a school district can have at any time to 30 percent for unified districts and 15 percent for elementary or high school districts. With Students FIRST, Class B bonds are limited to five percent of a district's net assessed value (NAV) for elementary or high school districts and 10 percent for unified districts.

Students FIRST also allows districts to obtain voter approval for capital overrides. The intent is to allow local control of decisions to exceed the state standards. The maximum life of the overrides is seven years but they can be for unlimited amounts and can be overlapping.

The public elections for these bonds and overrides can be held every two years on the second Tuesday in November.

**The School Facilities Board**

Replacing the Capital Facilities Board, which performed a similar function — albeit much more limited — the SFB is comprised of nine members, including the Superintendent of Public Instruction and eight members who are appointed by the Governor according to specified areas of expertise. The SFB has responsibility over a Capital Reserve Fund from which they will distribute monies to fulfill school districts' needs in terms of correcting existing deficiencies, building renewal, and new construction.

**Gross square footage standards**
The state's minimum adequacy guidelines are defined in the law in terms of gross square footage per pupil. These square footage requirements vary according to grade level and school size.

Schools are not considered inadequate if other similar schools in the district exceed the square footage standard, and the SFB may modify the square footage requirement for extraordinary circumstances related to student count, geography, and grade configurations. The standard includes modular and portable buildings, but does not include buildings used solely for district administration, vehicle storage, and other non-academic purposes.

**Criteria for the standards**
Specific criteria were drafted into the statute in order to address concerns brought forward by the low-wealth districts whose participation in the original lawsuit resulted in the two landmark Supreme Court decisions *Roosevelt v. Bishop* (1994) and *Hull v. Albrecht* (1997). For example, the law requires that there be sufficient and appropriate space and equipment to comply with the gross square footage guidelines. Students FIRST also reiterates the requirement for compliance with applicable federal, state and local building and fire codes and laws. Evaluation of school buildings must also consider factors such as structural soundness and the extent to which building systems (i.e. roofing, plumbing, electrical, etc.) are in working order and capable of being properly maintained.

**Deficiencies Correction Fund**
The Deficiencies Correction Fund (DCF) was established to bring all existing buildings up to the minimum adequate guidelines. A statewide assessment of each school district will take place during 2000 to determine deficiencies. The state will not correct deficiencies for elective courses that require facilities in excess of the standards. As an estimate, prior to completion of the statewide assessment, the legislature appropriated $35 million each year for FY 1999 to 2003 from the capital reserve fund to the DCF. An additional $15 million are appropriated for FY 2000 and FY 2001, respectively. All deficiencies must be corrected by June 30, 2003 and the fund is repealed on July 1, 2003.

**Building Renewal Fund**
The Building Renewal Fund is for major renovations and repairs, upgrading systems and areas to maintain or extend the life of school buildings, as well as to cover related infrastructure costs. Funds may not be used for new construction, remodeling of interior space for aesthetic or preferential reasons, exterior beautification, demolition, soft capital items, or routine maintenance. The Capital Reserve Fund received $75 million intended for building renewal for FY 1999, and similar amounts are appropriated for future years pending changes as requested by the School Facilities Board. It is important to note that the Building Renewal Fund is on "auto pilot" – the State Treasurer is told by the School Facilities Board how much money to take out of the Treasury, thus taking the Legislature out of the process.

**New School Facilities Fund**
To fund new school construction, "Students FIRST" provides a New School Facilities Fund which receives monies through a formula based on costs per square footage. The figures may be adjusted annually based on

construction market costs and the base is increased by five percent for rural districts. As an incentive to districts to arrange for land donations from developers and others, the statute allows 20 percent of the value of any donated land to be placed into the district's capital outlay account.

The SFB received $200 million for FY 1999 for distribution to districts' New School Facilities Funds. Unencumbered monies at the end of each fiscal year are transferred to the Capital Reserve Fund. District governing boards must create an annual capital plan that consists of enrollment projections, description of new schools or additions, and long-term land need projections. Districts that need a new school or addition within four years or land within 10 years must submit a capital plan and a request for monies from the SFB. Districts can also apply to the SFB for replacement of school buildings.

**State school facilities revenue bonds**

In the event that state funds are insufficient, revenue bonds may be used for acquiring real property and constructing new schools. Up to $200 million in state school facilities revenue bonds may be issued by the SFB each year. These ten-year bonds are paid from the proceeds of the state school fund and state portion of the transaction privilege tax. These are also subject to legislative approval.

**Soft Capital Allocation**

The Soft Capital Allocation is to be spent only on short-term capital items required to meet academic standards. Once standards are met, these dollars can be used for administrative soft capital needs. As stated earlier, this is on a per-pupil basis, ranging from $225 to $272 per pupil. Beginning FY 2000, the Soft Capital Allocation replaces the Capital Levy Revenue Limit (CLRL) as part of the equalization base.

**Equipment Guidelines**

The Students FIRST law required the SFB to address, among other areas, equipment in its adoption of minimum adequacy guidelines. This area proved to be one of the more controversial. Some members of the SFB wanted to define "equipment" as "fixed equipment" such as hoods, sinks, etc. that one would expect to find in a science lab. The majority of the members of the board, however, voted to include a list of "soft capital" items such as microscopes and other "non-fixed" equipment.

During the development of these guidelines ATRA had maintained that the Students FIRST law by no means called for the SFB to supplant the function and responsibilities of school district curriculum designers and governing board members. Students FIRST is, first and foremost, a funding mechanism for school construction and repair. ATRA argued that it should not have become a tool to micromanage school district expenditures.

The problems leading up to the enactment of Students FIRST were never that the school districts did not have the competence to decide how many microscopes are required in a lab. Even if that were the case, the SFB is certainly in no better position to do so. Rather, the problem was always a matter of funding a system that previously relied so heavily on voter-approved and unequalized property taxes to fund school buildings.

Under Students FIRST, the state is expected to pay for the building structure and fixed equipment. Funding for soft capital items such as computers and instructional tools increased by 28 percent with the soft capital allocation. The appropriation package that came with the enactment of Students FIRST included a new $36.5 million for soft capital. This was added to the $134 million in existing soft capital (formally called CLRL), for a total of $170.5 million available to districts to use, at their discretion, for soft capital items.

While this soft capital revenue should be the primary source for lab equipment and soft capital items, there are still other funding sources, such as capital outlay (CORL) and voter-approved capital overrides.

There are also concerns over where the SFB set the bar for computer technology, requiring, among other things, a multimedia computer "for every 8 students, on a school wide network."

**Charter schools**

A controversial part of the school finance debate since the *Roosevelt v. Bishop* decision has involved the status of charter schools. "Students FIRST" contains language that statutorily excludes charter schools from the "general and uniform" constitutional requirement. It also replaces the transportation support level, CLRL, CORL, and additional capital assistance with a new lump sum of "additional assistance" and increases funding by approximately $300 per pupil. Equalization assistance is distributed to charter schools as a single amount based on average daily membership (ADM) without categorical distinctions between maintenance and operations and capital.

**A Property Tax Cut?**

Of particular interest to taxpayers when Students FIRST was passed were the claims that this law would ultimately result in a dramatic reduction in secondary property taxes. We are skeptical that the reforms associated with Students FIRST will actually result in the much-heralded local property tax cut. While there are new lower limits on bonded indebtedness, capital overrides can still be approved every year for unlimited dollar amounts. Further, the overrides, which can last for up to seven years, can overlap.

In the 20 years since the 1980 reforms it appears Arizona has failed to attain its goals to reduce reliance on property taxes, to equalize tax burdens, and to equalize per-pupil expenditures among its school districts.

**Charter School Finance – Introduction**

Charter schools and the number of students in charter schools have more than tripled since the charter school law was passed in 1994. Charter schools comprise approximately 5 percent of the state's public school enrollment and operate one-in-five public schools in Arizona. Although charter school finance is much less complicated than the finance structure for district schools, it represents a growing percentage of public money spent on K-12 education[1]. This simplicity is a result of charter schools inability to assess property taxes and the child-centered nature of charter school revenue. Charter school finance can be described by examining the generation of charter school revenue (counting students), the sources and allocations of revenue, and charter school reports describing uses of revenue.

**How Do Charter Schools Generate Revenue?**

Much like district schools, charter schools are paid based on the number of students they educate and they both receive one-twelfth of their funding each month[2]. These payments are called apportionments. The Arizona Department of Education adjusts both types of schools' apportionments based on the number of students attending each school. Both types of schools have the same fiscal year, July 1 to June 30. The formulas used to calculate actual per-pupil funding are very similar for both types of public schools. Different than district schools, charter schools have two additional student reporting requirements because they are funded on a current-year basis. Districts are funded on a prior-year basis because during the first half of each fiscal year they are paid on their count from the previous year – districts' apportionments are only adjusted after two student count reports well into the school year. Charter schools are funded on a current-year basis because they have to project student attendance for their first three payments, and then an actual counting of students occurs to enable the ADE to adjust their next three payments to reflect a "current-year" student count. A more detailed description of the charter school portion follows.

Since most charter schools are start-up organizations (an average of 50 per year since 1996), there must be a method of accurately estimating the number of students who will attend the school each Fall. To accomplish this, the Arizona Department of Education (ADE) devised a projected enrollment reporting form due each May with the names, prior schools of attendance, projected special needs, gender and ethnicity of all students enrolled in the charter school for the following Fall. Students must actually *enroll* in the charter school to be included in this form which includes requiring parents to submit birth and immunization records in addition to other information. These forms determine the July, August and September apportionments (until fall 1997, these forms determined apportionments for July through the school's 40$^{th}$ day adjustment). Charter schools signing charter contracts after the May deadline for projected enrollment must submit this form with the charter contract and payments are made accordingly.

In 1997, the Legislature amended the charter law to force all charter schools into a current-year finance structure. The law did not include a mechanism for this shift, so the ADE created a

[1] Charter and district schools are both publicly funded. District schools are government-operated whereas all but a few charter schools are privately-operated.

[2] Charter schools in their first year of operation are on a different funding schedule described in the following paragraph.

system to enable them to pay charter schools on a current-year basis. Since this change, the ADE (in cooperation with the Arizona State Board for Charter Schools – ASBCS, and the State Board of Education - SBE) requires an early September headcount of all charter school students. The headcount is conducted during a pre-determined week and charter schools must submit this headcount in a timely manner or risk not receiving an October 15th payment. This headcount enables the ADE to adjust payments that had been based on the May projected enrollment, to a current-year headcount. The October 15th payments to charter schools reflect these adjustments. Adjustments are made for each reporting requirement so that each one-twelfth monthly apportionment reflects the most accurate student count possible. If a school's enrollment goes down, it may not receive a payment one month or it may receive a reduced payment. If a school's enrollment increases, it will receive a larger payment the following month. The ADE tries to make sure the school is only getting paid for the students it is currently educating.

Charter schools also submit 40th and 100th day ADM counts to the ADE. Charter schools have 12 days from the 40th or 100th day to submit this count or they will not receive the next month's payment (the ADE requested permission from the ASBCS and SBE to withhold payments from schools filing this report after the 12-day deadline). Charter schools also submit a year-end enrollment form.

Charter schools also complete a 200-day ADM calculation if they are providing at least 200 days of instruction (beginning in the 1998-99 school year, school conducting at least 200 days of instruction can have 5 percent added to their base equalization amount). Payment adjustments as a result of the 200-day count will be made in the following September or October. Currently, more than 20 charter schools plan on having 200-day or more school years.

**Table 4 - Charter School Monthly Payments**

| | Percent of Annual Revenue Paid First Year of Operation | Percent of Annual Revenue Paid At Least Second Year of Operation | How Payment Amount is Determined |
|---|---|---|---|
| Jul | 1/3 | 1/12 | May projection |
| Aug | | 1/12 | May projection |
| Sep | | 1/12 | May projection |
| Oct | 1/12 | 1/12 | September headcount |
| Nov | | 1/12 | September headcount |
| Dec | 1/12 | 1/12 | 40th day count |
| Jan | 1/12 | 1/12 | 40th day count |
| Feb | 1/12 | 1/12 | 40th day count |
| Mar | 1/12 | 1/12 | 40th day count |
| Apr | 1/12 | 1/12 | 100th day count |
| May | 1/12 | 1/12 | 100th day count |
| Jun | 1/12 | 1/12 | 100th day count |

Charter schools submit special education census numbers in December and February of each year, similar to district schools. Since a school receives additional money for a special

education student and this money is part of the monthly apportionments, the charter school projects special education enrollment in May, and payment adjustments as a result of the two official census counts are made in January and March.

**Revenue Allocation and Sources**

Several states with charter school laws calculate charter school student funding based on a percentage of district school per-student funding. For instance, New Hampshire's charter law provides for 80 percent of a district's per-student funding. Arizona's law allows for charter schools to calculate their revenue based on 100 percent of the funding formula.

**Start-Up Revenue**

There are approximately 75 new charter schools beginning operation each fall. These charter schools receive one-third of their funding July 1st, and then they don't receive payments in August, September and November. First year schools receive one-twelfth of their funding in each of the remaining months.

Until 1999, charter schools could apply for a start-up grant of up to a $100,000 from the $1 million state stimulus fund. This grant fund was supplemented with federal start-up aid. The average grant from 1996-99 was $21,800 per school. Due to changes in state and federal law as well as a resultant lawsuit (the Federal Deduct case), the State of Arizona is no longer eligible for the federal start-up aid. As of 1999, individual charter schools are eligible to apply directly to the US Charter Schools Office at the federal Department of Education for start-up grants. The Arizona Legislature un-funded the state stimulus grant in 1999. Charter schools receiving either the state or federal grant money must file completion reports appropriately documenting all expenditures of these grants.

**Calculating the Revenue**

Charter schools calculate their base support level similarly to district schools. Both types of public schools use a similar worksheet for determining base support level and a weighted student count. This means that all public schools receive the same amount of funding for a hearing impaired child, or a K-3 grade student, or if they serve less than 99 students. The major differences in revenue calculations between public schools are found in the area of capital, or for charter schools, in "Additional Assistance."

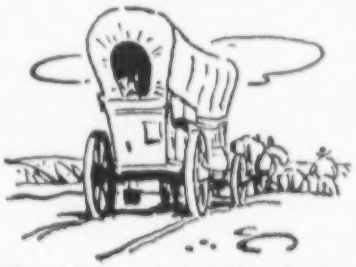
Charter schools and district schools were put on distinctly separate paths for the calculation of capital assistance with the 1998 passage of Students FIRST. Students FIRST resulted in approximately $300-400 new dollars per child in lieu of capital assistance (these amounts vary by school size and grade levels served; see Appendix B for more detail). Students FIRST also gave charter schools increased flexibility in how they spend their money, essentially making their money fungible. Charter school revenue may be spent however charter schools deem appropriate; charter school revenue does not come with categorical "strings." Prior to Students FIRST, and still in districts, revenue was generated based on categories of funding and revenue could generally only be spent within those categories.

We have calculated revenue for a charter school for demonstration purposes. Please note that the calculations depend on the number, grade level and kind of students served by the school. Also note that worksheet D calculates "Additional Assistance." The per pupil revenue amount

for our charter school is $4,859.50. (The average charter school per pupil revenue for the 1997-98 school year was $5,421 compared to $5,518 for district schools. Charter school per pupil expenditures for the same period were $4,213 compared to $6,381 for district schools.)

**District-Sponsored Charter Schools**

Nearly 20 percent of Arizona's charter schools are sponsored by school districts. Nearly all of these schools are located outside of the sponsoring school district's boundaries. District-sponsored charter schools' base support level is calculated at the lowest weight, or the formula treats every district-sponsored charter school as if it has more than 600 students[3]. This is different than charter schools sponsored by the ASBCS and SBE; board-sponsored schools calculate revenue based on true student counts. Other than this deviation, district-sponsored charter schools receive 100 percent of their revenue, similar to schools sponsored by the ASBCS and SBE. District sponsors, however, may charge a fee to charter schools. Currently, several districts charge a charter administration fee of between 4 and 9 percent of the charter school's total expenses. There are some exceptions for large capital expenditures, but generally all expenditures are considered when calculating this fee. The rate of this fee depends on the number of students in the school – larger schools are assessed at 4 percent and smaller schools at 9 percent. Conservative estimates calculated at the lower percentage figure show that districts that are sponsoring schools are making more than $900,000 from these fees. It is also unusual for a fee structure to be based on expenditures rather than revenues; in most states administrative fees to districts are a percentage of public revenues.



District-sponsored charter schools may also elect to receive transportation funding according to the number of miles students are transported. The schools receive either $1.59 or $1.95 per route-mile as described in state law. The schools may reimburse parents for transporting children or the school may transport the students (yellow bus, van, etc.). Students FIRST provides for the phasing-out of this provision by June 30, 2000. After this point, district-sponsored charter schools will receive transportation funding as part of the additional assistance calculation and this money will be fungible. A JLBC analysis of fiscal year 1999 transportation funding found that 24 district-sponsored charter schools calculated transportation on a route-mile basis. The total transportation amount for these schools was $10,039,164, or an average of $2,144 per student attending the school. A couple of Phoenix-area, district-sponsored, charter schools generated approximately $6,000 per student in transportation funding. Several schools collect either $1.59 or $1.95 per route mile from the state, and reimburse parents 10 or 15 cents per mile. This route-mile reimbursement method of paying for transportation allows several district-sponsored charter schools to make $1.50 per mile while charter schools sponsored by the ASBCS and SBE have to make transportation decisions based on their overall per-pupil funding. There is even student recruitment competition between district-sponsored charter schools based on the reimbursement rate paid to parents for transporting their children.

[3] Work sheets A and B show how the amount of money each student generates is dependent on the number of students in the school. Larger schools generate less money per pupil.

**Federal Funding**

Charter school students are similar to other public school students for the purpose of eligibility for federal entitlement programs. These programs include the range of federal programs, from School-to-Work, to Migrant Education, to Special Education, to traditional Title I. Charter schools, regardless of sponsor, apply directly to the state or the federal department of education for these types of programs, depending on which entity administers the program. Eligibility in income-sensitive programs is determined by eligibility for the National School Lunch Program (77 charter school sites actually participate in the NSLP although most collect the income-related data). All charter school collect this information each fall and new schools receive their federal money the following May. Charter schools in at least their second year of operation may use a prior year's count to project program eligibility, and actual count adjustments are made each May. Approximately 40 percent of Arizona's charter school sites participate in at least one federal funding program.

**Revenue Sources**

Charter schools must categorize their revenue and expenditures by source, either federal, state, local or intermediate. Charter schools receive the majority of their funding from the state's General Fund. Specifically, according to the 1999 Annual Report of the Superintendent of Public Instruction, charter schools receive 70 percent of their revenue from the state, 15.6 percent from federal sources, 13 percent from local sources and 1 percent from intermediate sources. Charter schools account for 2.8 percent of K-12 revenues (from all sources) and 1.9 percent of K-12 expenditures.

Different than the reporting for government-operated schools, "local" revenue sources for state board-sponsored charter schools are not public funds. Local funds for these charter schools are contributions, money generated from the sale of food, and other such revenue. Several district-sponsored charter schools reported their state equalization assistance as local revenue rather than state revenue. Also, "intermediate" revenue sources in charter schools are defined in the Uniform System of Financial Records of Charter Schools as gifts or resources from counties, such as donated equipment or buildings.

**Industrial Development Authority Bonds**

In 1999, the Arizona Legislature enabled charter schools to apply to Industrial Development Authorities[4] (IDAs) to issue tax exempt bonds on behalf of charter schools. IDA bonds are sold to investors whose interest payments are tax-free. The proceeds from the sale are then loaned to qualifying private entities, i.e. charter schools. Typical beneficiaries of IDA financing include airports, sewage or solid waster disposal facilities, industrial park facilities, as well as private, and now public charter, non-profit educational institutions. As of November 1999, two groups of charter schools had been approved for nearly $50 million in bonds.

**Reporting**

[4] Industrial Development Authorities are local organizations that are authorized to issue tax exempt bonds on behalf of government entities for the benefit of private users.

The State Legislature modified the charter law in 1996 to direct the Auditor General and the ADE to develop a charter school record keeping and reporting system. The Uniform System of Financial Records for Charter Schools (USFRCS) was created in 1996 and since then, more than 25 USFRCS Memoranda have been issued to provide further clarification to the USFRCS.[5] The USFRCS includes a Calendar of Reporting Events that describes report deadlines and requisite information needed for different agencies.

Although charter schools complete more than 50 reports annually, there are a few that capture all of the financial information. Each charter school must complete an annual external audit that must be filed with its sponsor if it is sponsored by the ASBCS or SBE, or with the Auditor General if it is sponsored by a district. The audit is due nine months after the end of the fiscal year, or March 31st (this is a recent change; prior to 1999 audits were due 13 months after the fiscal year). An average charter school audit costs $4,000. The Arizona State Board for Charter Schools has a contract with a local accounting firm to review audits and provide summaries and recommendations to the board.

Charter schools must also complete an annual financial report similar to government-operated school districts. As of 1999, this report must include school-level expenditures. These reports are due October 15th to the ADE.

Charter schools must adopt an annual budget at a public meeting before July 15th. The schools must also advertise their budget meeting in a general circulation newspaper.

Charter schools must complete and distribute annual school report cards. The school report cards are due to the ADE in May and must include school-level data.

Charter schools also complete an October 1st enrollment and ethnicity report and a December 1st Limited English Proficient study to determine eligibility for related funding.

**Charter School Finance Recommendations**

Calculate base support level similarly for all charter schools, regardless of sponsor.

Calculate "additional assistance" similarly for all charter schools, regardless of sponsor. This means district-sponsored charter schools will no longer be able to calculate transportation funding based on route-miles. This could potentially save the state $9 million.

Implement a system to assign a unique student identifier for the purpose of projecting enrollment and counting students for payment. This would give charter schools an additional two months to recruit students in the summer and guarantee against double-counting students and counting "phantom" students for the purpose of payment.

[5] The USFRCS was developed to encompass USFR for districts and upcoming federal reporting regulations. The ASBCS has exempted more than 35 charter schools from the USFRCS as provided in the charter law. These exempted schools must still comply with all reporting requirements and must utilize Generally Accepted Accounting Practices and Generally Accepted Auditing Standards.

Remove the one-third up-front funding that new charter schools receive. With increased financing opportunities, charter schools no longer need the up-front funding.

Move all schools, especially charter schools, to an absolute real-time funding system. This will reduce the inequities in reporting between charters and government-operated schools, and protect against double-counting and over-counting students.

**Per-Pupil Spending**

You have undoubtedly heard that Arizona ranks near the bottom in spending per pupil in K-12 education funding. This refers to a National Education Association (NEA) statistic that ranks Arizona 50th out of 51 (including the District of Columbia) in K-12 per-pupil spending. Few articles on education issues appear in the state's newspapers that do not mention this statistic.

Few people seem to be questioning the validity of the statistic, despite the fact that the NEA admits the Arizona figure is an estimate (as are the data for 19 other states in their analysis) and the Arizona Department of Education publicly dismisses the NEA number as fiction. But what is worse, there appears to be no public discussion as to what the statistic means and what public policy decisions, if any, should be driven by it. Does this ranking mean that all other states, except for Utah which ranks 51st, are doing a better job educating children than we are?

This ranking is for maintenance and operations (M&O) spending in FY 1996-97. The vast majority of a school district's M&O budget, often 90 percent or more, is for salaries and benefits. Therefore the two major budget decisions for schools in any state relate to employee pay and student-to-teacher ratio.

Since M&O expenditures are primarily for employee pay, it is important to recognize that this ranking does not control for regional differences in cost-of-living. Few people know that the same NEA publication that ranks Arizona 50th in spending also ranks us 10th in average salaries for instructional staff. Our ranking climbs to 3rd when you control for differences in per capita personal income. Arizona's instructional pay continues to rank high despite the lower ranking one might expect from our ongoing need in a rapidly growing state to hire new teachers who often start at the bottom of the pay scale.

The other dimension driving this statistic is student-to-teacher ratio. We live in a state with a rapidly growing student population. In fact many of the lowest per-pupil spending states have similar growth challenges. Many states with high per-pupil spending have numerous communities with small, stagnant, or declining student populations. Think about it. It is possible to increase statewide per-pupil expenditures without spending a single dollar more on education. Simply reduce the number of kids.

There has been considerable controversy surrounding the issue of class size and student-to-teacher ratio. This is not only an important policy question for our K-12 schools, it also goes to the heart of how much we spend in our schools. From a purely economic standpoint, full classrooms provide for greater *overall* funding and more efficient use of funds than those that are half full. Both the Goldwater Institute and ATRA have long advocated that student-to-

teacher-ratio decisions should be left up to individual school districts and charter schools. It should not be a matter of state policy.

Financially, Arizona benefits from the fact that three-quarters of Arizona's K-12 students live in our two urban counties, Maricopa and Pima. This high concentration of students allows for a much more efficient delivery of services than exists in many other states where the population is more spread out. This explains why we are able to pay instructional staff more than most other states.

Before we let ourselves be persuaded by those who herald this ranking as proof of a lack of taxpayer commitment to education, it should be noted that the NEA ranking does not take capital expenditures into account. Yet few states are ahead of Arizona in K-12 expenditures for capital.

Several questions arise from this per-pupil spending debate in Arizona, but one of the most poignant has to do with charter schools. As we stated earlier, the number of charter schools has tripled since 1994. If per-pupil expenditures are so inadequate, would approximately 75 new charter schools begin operation each fall (and keep expenditures below district averages)?

Of course, none of this says anything about student achievement. Low-spending Utah is ranked in the top 10 for urban districts in reading, science, and math in the federal government's National Assessment of Educational Progress (NAEP). Urban districts in Utah and Arizona did better than those in New York and Connecticut, the two highest per-pupil spending states of those participating in the NAEP.

But we don't have to look outside Arizona to find that there is no correlation between per-pupil M&O spending and academic performance. Phoenix Union's spending per-pupil is over 40 percent higher than that in Tempe Union. Yet Tempe Union scored significantly higher on the Stanford 9 in every category. Any further debate on K-12 funding should be focused on what it will take to improve academic achievement, not on whether we are spending as much per-pupil as New York.

## Glossary

You'll hear these words & acronyms tossed around in discussions of education finance.

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| Adjacent Ways | School districts can levy primary property taxes outside the budget limits for capital projects adjacent to school property. Common examples are sidewalks, sewers, utility lines, roadways, etc. Unlike other capital improvements paid for through capital overrides or general obligation bonds, no public discussion is required for adjacent ways projects. Although these are often basic capital needs, the current policy of the School Facilities Board (defined later) is not to pay for projects off school property. |
| ADM | Average daily membership (defined in legislation) is the average adjusted enrollment through the first 100 days of the current school year. This is the number used for most budget calculations. |
| Assessment Ratios | In Arizona, property is classified by its use for purposes of taxation. Each class is given an assessment ratio, which range from 1% to 25%. The ratio is applied to both primary and secondary property values. Residential property is assessed at 10% while commercial and industrial property is assessed at 25%. |
| Basic Aid | See equalization assistance. |
| Budget Balance Carry Forward | District can carry forward as much as four percent unspent budget capacity from its RCL in one year to build extra spending capacity in the next. It does not cause a direct increase in property taxes but could negate a tax decrease. |
| Capital | Capital expenditures are those that fund tangible assets such as facilities and equipment, as well as renovation, major maintenance, and land for school construction. |
| Capital Overrides | Under current law, capital override elections can be held on the second Tuesday in November to fund items above and beyond the state's minimum adequacy guidelines. The maximum life of the overrides is seven years but they can be for unlimited amounts and can be overlapping. |
| Capital Appreciation Bonds | CABS are issued at a discounted face value. The compounded interest payments are deferred for years and do not count against state debt limits. By refinancing existing bond obligations with CABs, districts are able to borrow more than with general obligation bonds. |
| Career Ladder | An adjustment to the RCL – as teachers' advance on the ladder, by improving their skills or increasing their responsibilities, they get pay increases. The state funds 2/3 of the program & the balance is funded locally. For every percentage increase in career ladder funding the qualifying tax rate (QTR) increases two cents for an elementary or high school district and four cents for a unified district. |
| Charter School | Charter Schools are independent public schools. They are publicly funded but privately operated. Charter Schools receive the same M & O funding as district schools, but they cannot access revenue through bonding. |
| CLRL | Obsolete. Capital levy revenue limit – for capital expenditures only. The CLRL was a per student dollar amount with adjustments for rapid growth districts. With Students FIRST, CLRL was transformed into the soft capital allocation. |

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| CORL | Capital outlay revenue limit – originally meant to be state assistance for books, equipment, and supplies, the state now allows this money to be transferred to the M & O budget. The amount is based on a district's weighted student count. The amount per student is determined by district size and grade level. There are 4 exceptions to this limit. A district can exceed (override) the CORL with voter approval. |
| County Education Rate | Each county, by state legislative mandate, must levy this tax (currently $0.5217) to help fund the state's equalization aid to school districts. The rate is set by the state legislature. |
| Debt Service | Principal and interest payments on bonds. |
| Desegregation Expenditures | These expenditures are any made in an effort to comply with a federal court order or agreement with the Office of Civil Rights. These expenditures are outside the RCL and have provided an easy means for desegregation districts to increase their spending and property tax levies without voter approval. |
| Excess Utilities | Funded by unequalized property tax levies, excess utilities represent any increase over actual utility costs for FY 1984-85 (with some exceptions relating to costs associated with career ladder or teacher compensations programs). |
| Endowment Trust Fund Earnings | The state of Arizona holds in trust 9.4 million acres of land, which generates revenue from interest and lease payments. Schools (K-12) are the largest beneficiaries with about 86% of the trust land assigned to them. In fiscal year 1997, they received about $110 million from the Trust Fund. |
| Energy Saving Devices | The purchase and operational costs of energy saving devices are exempt for the RCL if the savings or rebate results in a documented reduction in utility expenditures. This is being phased out and cannot be levied for after 2000 [check year]. |
| Equalization Assistance | The purpose of equalization assistance (also called basic aid) is to create a system that keeps each district's tax rate and per student expenditure roughly equal. A formula determines how much each district can spend and how much money they can raise through local property tax. Through equalization assistance the state provides the difference between the two amounts. |
| Equalization Base | A school district's expenditure capacity. The RCL, CORL and soft capital allocation combine to determine the total amount districts can spend per student. |
| Excess Insurance | Excess property and casualty insurance costs represent any increase greater than 150 percent over the FY 1984-85 insurance costs, after adjusting for the actual percentage increase in a district's budget limits since FY 1985-86 and after eliminating additional monies for career ladder or teacher compensation programs. This amount is in excess of the RCL and funded by local property taxes. In 1995 the legislature implemented a five-year phase out. Therefore FY 1999-2000 is the last year this can be levied for. |
| FF&E | Furniture, fixtures and equipment. These items are not included in the square foot cost for school construction. |
| General and Uniform | A constitutional requirement to fund an adequate public school system that meets a standard of equality. This phrase, "general and uniform," is the basis for the current Supreme Court ruling that our current system of capital finance is unconstitutional. |

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| General Obligation Bonds | G.O. bonds are secured by real property and are liens on that property. They are the most common instrument used by districts to finance construction and renovation. In Arizona, elementary and high school districts debt limit is 15% of the assessed value. It is 30% for unified districts. |
| Homeowner Rebate | Additional aid from that state to school districts. This rebate subsidizes homeowners' school primary taxes. The state pays 35% of the homeowner's primary tax, up to $500. |
| IDA Bonds | In 1999, the Arizona Legislature enabled charter schools to apply to Industrial Development Authorities[6] (IDAs) to issue tax exempt bonds on behalf of charter schools. IDA bonds are sold to investors whose interest payments are tax-free. The proceeds from the sale are then loaned to qualifying private entities, i.e. charter schools. Typical beneficiaries of IDA financing include airports, sewage or solid waster disposal facilities, industrial park facilities, as well as private, and now public charter, non-profit educational institutions. |
| Levy | Imposition of a tax or that amount taxed. |
| Maintenance & Operations | The day to day costs of education, including teachers, administrators, other staff, maintenance, insurance, utilities, etc. |
| Net Assessed Value (NAV) | Each school district has a primary and a secondary NAV, as do other taxing jurisdictions. It is determined by multiplying the primary or secondary value of a property by an assessment ratio as determined by the classification of property. The secondary NAV determines bonding authority for capital needs. See also: primary property values and secondary property values. |
| M&O Override | Voter approved actions that raise additional funds over the state limits. M & O overrides can be up 10% of the RCL. An additional 5% override is possible for special programs aimed at improving student performance in grades K – 3. |
| Primary Property Taxes | Generally used to fund the maintenance and operation budgets of local governments, primary property taxes are limited to two percent annual growth plus net new construction. |
| Primary Property Values | The primary value is generally limited to 10 percent per year. However, the primary value must be increased by 25 percent of the difference between the past primary value and the new secondary value, if that value increase would be more than 10 percent of the past primary value. In no event should the primary value be more than the secondary value. |
| Qualifying Tax Rate (QTR) | A hypothetical tax rate that determines the amount of equalization assistance a district receives. |
| RCL | The revenue control limit is the sum of the base support level and the amount allowed by the transportation revenue control limit. The RCL, along with the CORL, establish a district's M & O expenditure limit. There are 4 adjustment and 8 exceptions to the RCL. |
| Registered Warrants | Eligible districts may budget outside the RCL an amount less than or equal to interest expenses for registering warrants or tax anticipation notes, both of which are basically short-term loans. |
| Revenue bonds | Bonds which are secured by an income stream. |

[6] Industrial Development Authorities are local organizations that are authorized to issue tax exempt bonds on behalf of government entities for the benefit of private users.

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| School Capital Equity Fund | A fund which provides eligible districts with money for capital improvements and construction. This fund is administered by the State Board for School Capital Facilities. Distribution of the funds can be in the form of a loan or grant, or a combination of the two. There are a number of eligibility requirements designed to funnel the money to districts that are unable to raise the funds locally. |
| Secondary Property Taxes | The purpose of secondary taxes is generally to fund such things as bond issues, budget overrides and special districts. Secondary tax levies have no overall limits. However, the theory is that secondary taxes are self-limiting since nearly all of them would require voter approval. |
| Secondary Property Values | Secondary property values are based on the full cash value of property. There is no limit on the amount of taxes that may be assessed or on the growth rate of assessed values. For example, the secondary assessed value of a property may rise 30 percent or more a year, if the full cash value of the property rises accordingly. |
| Soft Capital Allocation | A per-pupil amount that becomes part of the equalization base to be used only for short-term capital items (computers, lab equipment, etc.) |
| School Facilities Board | A nine member board (eight appointed by the Governor plus the Superintendent of Public Instruction) which approves, prioritizes, and distributes funds for capital expenditures for school construction and repairs. The board is unpaid. The Governor also appoints, on the recommendation of the board, an executive director who along with a staff conducts the day to day operation of the board. |
| Tax Credit | A tax credit directly reduces total tax liability by the amount of the credit. In contrast, a deduction reduces the amount of taxable income. |
| Teacher Experience Index | School districts will have teachers of varying experience levels. If a district's average teacher experience index (TEI) surpasses the statewide average, its RCL increases. |
| Transportation Revenue Control Limit | The transportation revenue control limit (TRCL) is based on a district's transportation expenditures in FY 1984-85 and changes to the transportation support level (TSL). |
| Transportation Support Level | The transportation support level (TSL) is based on a statutory formula that multiplies specified transportation miles by a state support per route mile per school day. |
| Unified District | Unified districts are consolidated districts that encompass all grades, K-12. Other district types are elementary (K-8) and union high school (9-12). |
| Weights | A feature of Arizona school finance that allows variance in per pupil spending. These weights are assigned a multiplier that provides additional dollars to a district's budget based on special characteristics of either individual students, groups of students or for district characteristics. Group A weights are based on grade level, while Group B weights are based on characteristics ranging from limited English proficiency to severe metal retardation. |

**Appendix A**
**Taxpayer Commitment Table**

Note: We have included both the adjusted and non-adjusted figures for two reasons. First, while government entities argue that they should be held harmless against the impact of inflation, taxpayers rarely have such guarantees. Can you imagine a retail store that insisted upon changing its prices constantly to keep up with inflation? How long do you think that store would stay in business? Obviously, there are cost and market considerations that go well beyond simple inflation adjustments.

The second reason is that, in a very real way, property taxes are already adjusted for inflation. When the county assessor determines the value of a property for taxation purposes, he will often increase that value from the previous year based on what the property market has been doing in that area. Meanwhile, however, state and local governments with the power to set tax rates rarely reduce the rate in proportion to the increase in property value.

| | State and Local per ADM | State and Local per ADM – Adjusted | Total K-12 Spending – State and Local | Total K-12 Spending – State and Local – Adjusted (99 dollars) |
|---|---|---|---|---|
| 1988-89 | $4011.33 | $5309.46 | $2,326,428,486 | $3,079,295,226 |
| 1989-90 | $4032.42 | $5121.43 | $2,377,149,618 | $3,019,128,388 |
| 1990-91 | $4136.34 | $5035.64 | $2,501,504,077 | $3,045,367,410 |
| 1991-92 | $4275.68 | $5006.3 | $2,671,275,983 | $3,127,742,481 |
| 1992-93 | $4270.88 | $4866.66 | $2,762,395,075 | $3,147,749,188 |
| 1993-94 | $4449.33 | $4939.61 | $2,979,904,135 | $3,308,262,628 |
| 1994-95 | $4588.93 | $4975.82 | $3,189,553,640 | $3,458,460,722 |
| 1995-96 | $4723.68 | $5006.64 | $3,419,650,193 | $3,624,492,043 |
| 1996-97 | $4973.33 | $5174.02 | $3,752,128,083 | $3,903,542,363 |
| 1997-98 | $5050.53 | $5158.27 | $3,922,219,228 | $4,005,887,613 |
| 1998-99 | $5610.65 | $5672.88 | $4,518,030,970 | $4,569,153,319 |
| 1999-00 | $5862.42 | $5862.42 | $4,888,778,783 | $4,888,778,783 |
| Change | 46.1% | 10.4% | 110.1% | 58.8% |

**Appendix B**

The Supreme Court ruled in 1998 that the new school finance bill is constitutional and it closed the case. The Students FIRST legislation defined "general and uniform" as district schools, and charter schools now fall outside of general and uniform. This distinction allows charter schools to receive a per pupil amount for capital and to not be subjected to the new building standards nor to the new state-level facilities board. This bill changed the amount of funding charter schools receive and impacted how they may spend this funding. Specifically:

Before Students FIRST, charter school received, per pupil:

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| CORL (range) | less than 100 students (most heavily weighted), $272.74 for K-8, $329.40 for 9-12<br>more than 600 students $225.75 for K-8, $267.92 for 9-12 |
| CLRL | less than 100 students (most heavily weighted) $211.91<br>more than 600 students $175.40 |
| Transportation | $174 |
| Capital Assistance | $146 for K-8/$219 for 9-12 |

Last year (1998-99) charter schools received the above funding, plus **$350** per student in capital funding and **$42.82** per student in CLRL (before weights). This funding comes with the same spending limitations as the CLRL and prior capital assistance.

This year these funding categories are collapsed to per pupil amounts of **$1404.01** for grades 9-12, and **$1204.67** for grades K-8. This money does not have the typical spending restrictions. This money may be used according to each school's needs.

**About Arizona Tax Research Association**

The Arizona Tax Resarch Association (ATRA) is the only statewide taxpayer organization representing a cross section of Arizona individuals and businesses. Organized in 1940, ATRA is the largest and most respected independent, objective and accurate source of public finance and tax policy information. ATRA's fundamental belief is that every governmental expenditure is directly related to a tax. ATRA's goal is efficient statewide government and the effective use of tax dollars through sound fiscal policies.

Generally, taxpayers have neither the time nor the expertise to monitor the complicated Arizona public finance system. On a daily basis, ATRA's professional staff scrutinizes governmental activity and expenditures related to taxation policy and procedure. Arizona's extremely complicated state and local government budget and levy limits make ATRA's "watchdog" budget review vital.